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IMPLICATIONS FOR JAPANESE AND TAIWAN ECONOMIES OF A RE-ORIENTATION  
OF TAIWAN'S ECONOMY FROM CHINA TO JAPAN UNDER CURRENT CONDITIONS

PROBLEM

The US is interested in the possibilities for Japan-Taiwan trade and its implications for Japan and Taiwan because of (a) the US strategic interests in Taiwan, increased by expanded Communist control of mainland China and (b) the part Taiwan may play in serving US strategic interests involving economic rehabilitation of Japan. This study attempts to analyze Japan-Taiwan economic relationships resulting from Taiwan-Japan trade, with emphasis on implications to (a) the political stability and anti-Communist orientation of Taiwan, and (b) the rehabilitation of Japan.

ASSUMPTIONS

1. The Chinese Communists will control principal economic areas of China, with possible exception of the border provinces, the northwest, and southwest, and of Hong Kong, Macao and Taiwan.
2. Vestiges of Nationalist resistance may exist in the southwest, northwest, and Taiwan. The Nationalists may endeavor to use Taiwan as a source of military and economic support, but will be incapable of effective, efficient integration of economies of non-Communist China and Taiwan.
3. A non-Communist Taiwan will continue.
4. Taiwan's political and economic stability are strategically advantageous to the US.
5. US will continue to control Japan.

CONCLUSIONS

US security interests dictate orientation of Taiwan and Japan to countries not under communist control or influence. Pre-war relationships

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between Taiwan and Japan established some basis for a complementary trade. However, post-war internal disorder in Taiwan has decreased Taiwan's ability under these conditions of disorder to benefit from Japanese trade or to contribute to Japan's economy. Continuation of rapacious maladministration of Taiwan would deprive both Taiwan and Japan of any potential benefit that might be derived from diverting Taiwan's trade from China to Japan. Reorientation of Taiwan trade with Japan could be reciprocally beneficial, however, if Taiwan could have an efficient administration, could receive fertilizer imports, and intensify its rice production for export, improve sugar production efficiency, and effect sounder integration of its internal economy.

#### DISCUSSION

##### I. Pre-war Japan - Taiwan Economic Relationships

Prior to World War II, Japan integrated the economy of Taiwan with its own for two reasons: first, economically, to develop sources of food and raw materials for consumption in Japan or for re-export, and second, militarily, to develop a base for military operations.

Economically, Japan was primarily interested in Taiwan's sugar and rice production. With supervision by Japanese technicians and extensive application of scientific techniques, including improvement of seed that permitted greatly increased yields, the Japanese developed Taiwan's agriculture to a point permitting large exports.

Militarily, Taiwan's economy became involved in Japanese plans for expansion. Industries were established to meet Japan's requirements in the program for expansion. The Japanese Navy desired improved harbors,

and ship-repair and petroleum facilities, in order to increase the scope of its operations in the South Seas. Aluminum and fertilizer industries were established to utilize Netherlands East Indies bauxite and phosphate rock. A complementary chemicals industry also was built.

Integration of the Japan - Taiwan economy was effected to a high degree. Rice and sugar-cane cultivation depended almost wholly on imported chemical fertilizers; these were imported from Japan. The last steps in sugar refining were completed in Japan. The paper industry depended on imports from Japan of wire, cloth, felt, sulphur and chemicals. Gold and copper ore from the Kinkashek mines were sent to Japan for refining and electrolyzing. Poorer ores were concentrated locally before being exported; but necessary chemicals — such as potassium cyanide, zinc dust, scrap iron for precipitating copper from mine water — all came from Japan.

Prior to the war, Japan provided about 85 percent of Taiwan's imports and received more than 90 percent of its exports, (some of which were sent to Japan for transshipment to other countries). Taiwan's principal exports of rice and sugar provided Japan with nearly 90 percent of its sugar and about 6 percent of its rice requirements. Other exports included fruits, dried sweet potatoes, fresh fish, salt, camphor, essential oils, alcohol and molasses. Taiwan's largest imports from Japan were fertilizers, textiles, metals, petroleum, processed foods and edible oils.

## II. The Taiwan Economy with Special Reference to Its Inadequacies

### Which Could Be Met by Reorientation of Trade with Japan.

Taiwan, whose economy is based primarily on agriculture, is more than self-sufficient in basic foodstuffs. In addition to rice and sugar,

which account for the greater part of the total production, it can produce an exportable surplus of sweet potatoes, vegetables, fruits, tea, camphor and essential oils.

Taiwan also has a small but varied industrial plant which includes petroleum refining, aluminum, chemicals, cement and paper manufacturing, ship repair, and sugar processing. It has sizeable timber reserves and produces sufficient low-grade coal for domestic requirements. It also produces some gold, copper and petroleum.

Taiwan's prosperity depends on maintaining surpluses in food production and a large volume of foreign trade to provide markets for agricultural products and processed foodstuffs, and import of fertilizers, cotton yarn and cloth, metals, chemicals and edible oils. After the war, the greater part of Taiwan's foreign trade was carried out on a rapacious, discriminating basis by agencies of the Chinese Nationalist Government.

A. Over-all Economic Situation in Taiwan.

Prior to the end of the war, the Taiwan economy was in a chaotic condition. Agricultural output had declined to pre-World War I levels; industry and trade had almost ceased. Inflation was raging as a consequence of Japan's large issue of notes to meet its wartime expenses in Taiwan. At the end of the war, administrative direction of the economy was lacking, with neither the outgoing Japanese nor the incoming Chinese able to correct the deterioration that had developed to extremes before the Japanese surrender. Since the end of the war, the Chinese have attempted little towards economic recovery. Rehabilitation has been ignored and production has depended largely on the enterprise and competence of local

Chinese Staffs and their use of local resources. The number and qualifications of Chinese who have administered the Taiwan economy are far below those of the deported Japanese managers and engineers. With economic administrative control divided between Nationalist Government agencies (chiefly the National Resources Commission) and the Nationalist's Taiwan Provincial Government, there has been confusion, conflict and lack of administrative direction. Except for permitting a separate currency, the Chinese Government has given little aid in solving Taiwan's needs for trade and imports. Taiwan, administered as a province of China, has been subject to the Chinese Government's exchange regulations, which has diverted the benefits to Taiwan by pre-empting the exchange earnings and by allowing only meager exchange allotments for imports. With the Chinese government-controlled exchange rate unfavorable to Taiwan in terms of the mainland currency, foreign trade has been slow to develop. Most of Taiwan's trade has been with the mainland to the disadvantage of Taiwan.

B. Agricultural situation in Taiwan

Uninspired and desultory rehabilitation and insignificant imports of fertilizer since the end of the war have prevented agricultural recovery. Recovery has been prevented further because of absence of unified planning and competent technical direction, such as was provided under the Japanese administration. There is lack of control over the allocation of agricultural resources; and experimental stations, seed farms and the agricultural association have deteriorated for want of capable technicians and government support. Agricultural needs include augmenting hydro-electric power output (for nitrogenous fertilizer manufacture--domestic output is less than 10 percent of consumption but can be perhaps tripled--and food processing), and rehabilitation of railway transportation facilities.

The lack of a coordinated farm program is reflected in the conflict and indecision over the crop goals of the island's two chief products, sugar and rice. Despite the substantial fertilizer requirements, sugar production has been favored over rice production by the government monopoly in the guise of the Taiwan Sugar Company and by government-directed price-control producing an artificial relation in the prices of sugar and rice, favoring sugar. This price situation is the antitheses of that generally prevailing elsewhere in the world. Creation of this artificial price relationship between sugar and rice was enforced primarily - (a) to increase profits that the Chinese Nationalist government monopoly could obtain from increases in sugar profits, and (b) to decrease popular discontent with the price of rice. This price policy, combined with allocation of land and fertilizer favoring sugar, has emphasized sugar above rice production.

Per capita agriculture production has been reduced even further below prewar levels because of the population increase from 5½ million in 1936 to an estimated 7 million in 1949 (including the influx of "mainlanders" in 1948-1949). This large reduction in per capita productivity necessarily affects both living standards and the size of the island's surplus. Although it is not possible to estimate current rice consumption, all indications are that there is little if any rice available for export. Due to a decline in living standards, the island sugar consumption probably has remained stable at 50,000 tons, leaving an export surplus of 218,000 tons in 1948 and 580,000 tons in 1949, as against 850,000 tons in 1936.

C. Industrial situation in Taiwan

The industrial plant of Taiwan, most of which was taken over by

the Chinese Nationalist Government in 1945 as a government monopoly, may be classified as (a) that designed to develop Taiwan's resources such as the fertilizer plant, sugar industry, transport and harbors, and the hydroelectric plants, and (b) that built in Taiwan to serve Japan's special requirements for aluminum plants, petroleum refinery, chemical plants for aluminum and paper processing, and the mining of non-ferrous metals.

Although some of the plants built for Japan's special requirements may not be entirely valueless, they are not an integral part of the Taiwan economy and can be discarded without affecting other segments of the economy. However, this has not been taken into account in allocating scarce resources. Investment expenditures have been greatest where the prospects for immediate returns to the over-all economy are least because (a) political prestige seems to be attached to such technically advanced but high-cost operations as aluminum and petroleum refining, (b) operational autonomy of each industrial unit within the government monopoly has resulted in the extent of its rehabilitation being determined by the interests and competence of its engineers and the ingenuity and influence of its managers in securing funds. Since almost no foreign exchange for imports of capital investment has been available because of the National Government's discriminatory exchange rates, development and improvements have been confined largely to repairing structures and buildings.

Except for harbor facilities, Taiwan's essential industrial plant has been generally neglected. This is due primarily to the fact that the Chinese administrative policies have not permitted credits for imports of the capital goods which are required for upkeep and rehabilitation. The

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rail system with present capacity of from one-half to two-thirds of the pre-war traffic, needs extensive repair trackage and rolling stock. The inadequate transport facilities already are impeding production of delayed commodity shipments.

Similarly, the Taiwan Power Company has been forced to improvise to restore and maintain power output. The chief war damage has been the destruction of the step-up transformers at the two largest hydro-electric plants. Undermaintenance of the transmission system and the steam plant added to import requirements. Provisional repairs have been made, but an outstanding engineering job was accomplished only through cannibalization; import requirements have not been reduced. Should the power be curtailed, essential functions as irrigation and operation of sugar mills would be hindered. Moreover, any chance of profitable development of aluminum or petroleum refining would be thwarted. It may be that, writing off the capital costs, some parts of this plant can be operated profitably, or that, for exchange considerations, subsidized operations may be desirable.

Although maintenance of power and railroad facilities has been accomplished through ingenious cannibalization without imports of repair and replacement equipment, inefficient production has resulted from the absence of experienced technical guidance in maintenance and operation. Replacement parts, or even new machinery, might be obtained from Japan now at lower costs and on shorter delivery dates than from other parts of the world.

III The Japanese economy with special reference to its requisite imports and potential exports and to how Taiwan best meets these needs.

Japan's economy is predominantly agricultural, but it also posses the only major industrial plant in the Far East. This plant comprises both heavy and light manufactures.

Japan's economy is not self-sufficient. It must import essential foods and raw materials, and as payment therefor must export. In the decade prior to the war, Japan did not export enough to cover the cost of its imports, but it made up the deficit through credits for shipping, services, and dividends and profits on foreign investments. As one of the consequences of war, Japan now must depend even more heavily on trade for its survival.

There is in general no shortage of capacity in the major industries of Japan: coal mining, finished steel, machinery and textiles (cotton yarn, rayon). There are large resources of low-grade coal and of water power. However, Japan lacks raw materials for its industries. All of its requirements of raw cotton and raw wool, and most of its needs for petroleum and salt, and for iron ore and low volatile coking coal for its steel industry must be imported. Even considerable imports are required to manufacture equipment and parts with which to maintain existing factories efficiently.

Japan also faces an ever-increasing gap between food production and minimum foods requirements of a rapidly growing population. Even before the war, Japan imported as much as 15 percent of its food.

By 1953, Japan's population is expected to reach 86.7 millions as compared to its present 81 million. The anticipated 1953 population is an increase of 30.8 percent over the 1930-1934 average, whereas the staple food production in fiscal year 1953 is expected to be only 16 percent above

the 1930-1934 average. There is little hope that food production will exceed this estimate because Japan long has practiced intensive cultivation, and nearly all of the arable land is already under cultivation. Projections based on the assumption of a self-sustaining economy by 1953, indicate as much as 30 percent of the total income from exports will have to be allocated to the purchase of food imports.

In view of the nature of the Japanese economy and especially of the stresses engendered by the war, it is urgent for Japan to develop markets for its products and sources for its raw material, food and other consumer needs. In the immediate prewar period, 53 percent of Japan's imports by value came from the Far East. Of total imports about 10 percent originated in Taiwan. The Far East was also Japan's best customer. The region, in general, took 60 percent of total exports, of which about  $6\frac{1}{2}$  percent went to Taiwan.

Because of geographical location and historical relationships, Japan naturally would trade with the Far East as much as possible. Short-run distortions caused by the war should decrease, but Japan no longer can hope to trade in the same pattern as before the war. Communist domination of many of its "natural" markets and sources in Northeast Asia raises doubt that the same volume and type of trade will be conducted as when that region was part of the Japanese sphere. Clearly, trade with a non-Communist controlled country like Taiwan will be eagerly surveyed by Japan.

An analysis of Japan's geographical trade pattern in the fiscal year 1948 illustrates the distortions caused by the impact of the war and

its after effects. In 1948, 80 percent of Japan's total imports originated in the US as compared to only 25 percent in 1936. Most of the increase can be ascribed to Japan's dependence upon the US for imports necessary to sustain itself on minimum standards. To a much lesser extent, it reflected the use of US appropriated dollars to purchase US goods. Thus only 10 percent of total imports were procured with US appropriated dollars in areas outside the United States—sugar from Cuba and Mexico, potash from Germany, fats and oils from Southeast Asia and the Philippines and tanning extracts from South and Central America.

SCAP projections consider changing the pattern of Japanese trade by raising the percentage of machinery exports in relation to all textiles. Nevertheless, it is hoped that textiles will constitute 51 percent of total exports in 1953 as compared to 26 percent for metals and machinery. Cotton textiles remain as a key export, although their relative importance is expected to decline because of the growth of competition. Japan has the capacity and technique to develop markets for cheap cotton fabrics in areas where native populations are too poor to buy higher priced fabrics. Japan hopes also to export rayon. Silk, however, faces a dismal future in view of the growth of synthetics.

Since Japan does not expect to be able to market as large a percentage of textiles as it did in the past, it hopes to balance this loss by increasing machinery shipments. About one-third of machinery production is destined for export, chiefly for the Far East which has indicated considerable demand for capital goods. Japan plans great expansion in such items as

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Japan - Taiwan Trade RelationshipsImport Requirements of JapanProduct

Food

Taiwan can supplyQuantityRice, sugar, sweet potatoes,  
fruits, vegetables 1/

Textiles

Raw wool

None

Raw cotton

None

Iron Ore

None

Coal (adequate reserves but  
inadequate production)Insignificant amount of soft  
coal, no low volatile coking coal

Rubber

None

Petroleum

None

Salt

Insignificant amounts

Imports Requirements of TaiwanProduct

Fertilizer

Japan Can SupplyQuantity

Textiles

None

Machinery

All requirements

Metal Manuf.

All requirements

Foodstuffs, beverage &amp; tobacco

All requirements

Limited quantities

1/ The amount available depends largely on Taiwan's internal factors. currently, little rice is available. Sugar is the only major product available, and it is questionable whether, in the absence of other considerations, Taiwan can meet world prices, c.i.f. Japan. Sweet potatoes, fruits, and vegetables are only a minor item in the trade. On the other hand, there appears currently, to be inclination on both sides, to exchange commodities on a barter basis without regard to world prices.

V Considerations of future Japan - Taiwan trade relationships.

A. Short-term factors to be considered:

1. Japan

- a. Japan needs every possible market for its economic rehabilitation.
- b. Japan no longer would pay the high cost for the industrial products of Taiwan. (Paper, aluminum, petroleum).
- c. Japan cannot depend on Taiwan having a rice surplus.
- d. Japan probably can purchase sugar from sources other than Taiwan at a cheaper price, (due to conditions such as climate irrigation and fertilizer inadequacies) but probably will enter into barter because of (1).
- e. Japan needs its own fertilizer.

2. Taiwan

- a. Taiwan needs Japan's machinery and railroad equipment for its railway system and power industry.
- b. Taiwan needs Japan's consumer goods.

In the immediate future Japan and Taiwan probably will expand exchange of goods on a barter basis. Japan probably will take Taiwan sugar, coal and salt and such rice as may be available in return for railway equipment, machinery, and cotton textiles, and other consumer goods.

Japan will be willing to enter into such barter because it is still in the formative stages of reviving its foreign trade and wishes to explore every possible market. As a result of its war effort, it has excess industrial capacity which it is anxious to use (a) to build up credits

for imports, (b) to justify its not being removed for reparations, and (c) to keep its labor force occupied. Since US appropriations and credits are subsidizing Japan by enabling it to procure raw materials for Japanese industry without having the usual cost considerations, Japan can exchange its industrial products for items which otherwise it could not obtain on a purely competitive basis on comparable terms.

For Taiwan, resumption of trade with Japan is important to the maintenance of its domestic economy. Without imports of Japanese capital goods, Taiwan would have to face the possibility of eventual deterioration of its railways and power supply, with consequent decay of its irrigation and industrial systems. In order to procure its requisite imports, Taiwan will be willing to subsidize its sugar industry, if necessary. Sugar provides Taiwan's only currently important export surplus.

The mutual desire of both countries to seize every opportunity to rehabilitate their respective economies should produce a trade rapprochement on a limited, governmental basis. Although trade with Taiwan will be an insignificant portion of Japan's total trade, Japan is too poor to overlook any possible source. Sugar imports that may be expected from Taiwan will represent two-thirds of Japan's sugar requirements, not an important factor in Japan's over-all requirements, but still important in filling a specific need. So too, exports to pay for the sugar will be a small percentage of Japan's projected exports but add some impetus to Japan's rehabilitation. For Taiwan, in the short-run trade with Japan will enable it to procure some of the capital goods so vitally needed for its reconstruction and rehabilitation.

B. Long-term factors to be considered:

1. Japan

- a. By 1953, it is hoped that Japan will be self-supporting.
- b. If the objectives of the US-directed "austerity" program in Japan are fulfilled, Japan should attain a sound economy, based on non-subsidized trade and more efficient integration of industry, with labor absorbed on a more economical basis than traditionally.
- c. Japan will be conducting its trade with much more attention to world prices as US subsidies are withdrawn.

2. Taiwan

- a. If Japanese capital goods have been produced during the short-term period, Taiwan's railways and power will be in a sounder condition.
- b. Taiwan probably will have improved its agricultural yields, especially if Japanese fertilizer becomes available.
- c. Japanese technicians may be permitted to go to Taiwan.

On the assumption that the present Chinese administration continues in power in Taiwan with the political and economic instability this has proven to entail: In the long-run it can be expected that Japan will not regard trade with Taiwan with the same eagerness as at present; Taiwan, on the other hand, probably will continue to be anxious to trade with Japan.

Japan's trade with Taiwan may well be of minor importance to Japan's over-all economy, because (a) Taiwan, in view of the uneconomic policies of the Chinese Nationalists would be considered as a possible

source only of sugar and insignificant amounts of coal and salt, (and a doubtful source of rice), and (b) although Taiwan may be a customer for Japan's capital goods, it will not have the means to pay for them.

On the basis of present conditions, it is doubtful that Taiwan will have much rice to export. The Taiwanese are consuming more rice than they did in prewar days, population has increased considerably, and because of internal security considerations more rice is being made available by the authorities to the urban population. Increased exports of rice can be expected only if the Taiwanese realize that their economy depends on imports of capital goods and that to pay for these they must make more rice available for export by shifting their diet to less desirable items. If the Taiwanese refuse to do this, Taiwan can be expected to have significance to Japan's economy only through sugar exports. Before the war, Taiwan supplied about 90 percent of Japan's sugar and it might be able to play an important part in filling Japan's post-war needs in that regard.

However, Japan may not take Taiwan sugar. Taiwan no longer has the advantage of being a member of the Japanese Empire; it has to meet world competition. On a 1933-1937 average price, Taiwan sugar was more expensive to Japan than other sources, principally the Netherlands East Indies. It would seem that in the absence of possible political considerations (e.g. Japan seeking to restore political influence in Taiwan), and assuming "normal" trade, Japan would prefer the cheaper NEI sugar to that of Taiwan.

Unless Taiwan is willing to take drastic steps to make rice and

cheaper sugar available for export, Taiwan cannot be considered a real market for Japanese goods. This will be so even though trade with Japan will continue to be of considerable importance to the Taiwan economy; Taiwan will still need Japanese fertilizer (which may be available in a few years), textiles, replacement parts and maintenance machinery, rolling stock and miscellaneous consumer items. Even then, however, Taiwan must be able to pay, either in cash or through the barter of vital commodities which Japan could not get elsewhere. Taiwan has no such commodities. Hence, to get its needs from Japan, it must seek to expand rice production and in proportion to its success with rice production, endeavor to produce sugar at a competitive price.

VI Effects of a Japan-oriented Taiwan trade on US security interests.

Because of its industrial potential, unique in the Far East, plus its large resources of trained military and industrial manpower, Japan is the key to development of a self-sufficient war-making complex in the Far East. Control of Japan's industrial machine would be of special value to the USSR, because the USSR needs the products of Japan's industry and because the Communists control much of Northeast Asia (Manchuria, North China, northern Korea) whose natural resources Japanese industry can utilize more efficiently. Hence, it is to long-range US security interest that Japan seek to exploit maximum trade with those countries which are non-Communist controlled, in order to (a) minimize Japan's dependence upon sources of supply which might be shut off at the discretion of the USSR, (b) or which dependence might be employed by the USSR and the Communists

of northeast Asia as a means of bringing upon Japan political pressure contrary to the interests of the US, (c) minimize economic penetration of Japan by the USSR and (d) utilize all available markets for Japanese products as a contribution to Japan's self-support.

Under present political and economic conditions in Taiwan Japan would have difficulty in using Taiwan either as a source of foodstuffs or as a paying customer. If the US attempted to aid the Taiwan economy by paying for Japanese exports of machinery and for fertilizer, the likelihood is that the present Chinese rulers would divert such aid to their own purposes and that the Taiwanese would get little end-use of the aid. If, on the other hand, a sound regime were in control in Taiwan, US aid could effect marked results within a relatively short term. Once Taiwan agriculture were put on an improved basis, and exports, especially of rice became available, it is probable that a mutually advantageous complementary trade with Japan can be re-established.

Although such trade would not be a large item in Japan's total trade, its effects on US security interests would be favorable. It would at least furnish Japan with a source of rice which it desperately needs. It would also be a market for Japan's textiles and machinery which while of not large magnitude would contribute to Japan's export trade and hence to Japan's economic stability. In addition, Japan, by furthering its trade with a pro-US Taiwan, will deprive the JCP of propaganda material for Communist claims that Japan can attain trade only with the Communist areas of Northeast Asia. The result would be the minimizing of that source of JCP effect on Japanese political stability.

In view of Taiwan's location in the Western Pacific, the strategic implications of Chinese Communist (and USSR) control of Taiwan and of Taiwan's political and economic stability as a deterrent to Communist infiltration are important to US security. If current political and economic instability in Taiwan is permitted to persist, conditions are favorable to Communist infiltration in the Island and probably ultimate Communist control. The establishment of a non-Communist regime in Taiwan which would be primarily devoted to the interests of the Taiwanese should result in creating an atmosphere more favorable to US security than presently exists in Taiwan. Such a regime would find that a major step in restoring political and economic stability to Taiwan is the re-orientation of its trade to Japan. Introduction of sound, national control together with US aid should lead to rapid improvement in the Taiwan economic situation, resulting in the availability of exports of agricultural products. With those bartered for Japanese industrial products, Taiwan trade would be put on a sounder basis. The resultant economic stability would further Taiwan political stability by creating popular support of the non-communist regime then in power.